

GOVERNANCE AUDITS IN CENTRAL BANKS: THE CBA EXPERIENCE

DISCUSSION PAPER DP-2025-02

Azat Gabrielyan, Anna Hakobyan and Karine Kalenchyan

CBA discussion papers present preliminary research or ideas at an early stage of development, published to stimulate professional discussion and gather feedback. The views expressed in the discussion papers are those of the author(s) and do not necessarily represent the views of the CBA.

GOVERNANCE AUDITS IN CENTRAL BANKS: THE CBA EXPERIENCE

DISCUSSION PAPER DP-2025-02

Azat Gabrielyan ⁽¹⁾, Anna Hakobyan ⁽²⁾ and Karine Kalenchyan ⁽³⁾

ABSTRACT

In this paper, the authors share their experience with governance audits in the central banks. The paper reflects upon the importance of governance audits in central banks, focusing on their role in strengthening internal governance frameworks, decision-making processes, and risk management practices. It highlights five key areas of governance audits: policies and procedures, board and committee structures, executive management, decision-making processes, and assignment management. While providing practical insights into using agile auditing methods, emphasizing flexibility, collaboration, and iterative processes, the paper also introduces tools such as gap analyses, interviews, and a self-developed materiality assessment model to enhance the comprehensiveness of governance evaluations. By sharing methodologies and experiences, the paper aims to support internal auditors in designing and executing governance audits tailored to the specific needs of central banks. It underscores the critical role of governance audits in fostering accountability, resilience, and alignment with international audit standards, while emphasizing that governance audits must remain iterative and adaptable to the unique context of each central bank.¹

Keywords:	Internal Audit, Governance, Central Bank, Governance Audit
JEL Codes:	M42, G38, D73, H83, L32
Authors/Affiliations:	(1) Chief Audit Executive, Internal Audit Department, CBA: azat.gabrielyan@cba.am (2) Deputy Chief Audit Executive, Internal Audit Department, CBA: anna.hakobyan@cba.am (3) Head of Operational Audit Division, Internal Audit Department, CBA: karine.kalenchyan@cba.am

¹ **Acknowledgments:** We are grateful to reviewers for their personal comments and contribution on earlier versions of this paper. All remaining errors are our own.

George Kabwe, International Monetary Fund
Wouter Bossu, International Monetary Fund
Elie Chamoun, International Monetary Fund
Katleen Seeuws, Institute of Internal Auditors
Kathryn Birn, Federal Reserve Bank of New York
Marcus Hornung, Deutsche Bundesbank
Lucia Hadarca, National Bank of Moldova
Kalhari Mayadunna, Central Bank of Sri Lanka

Mamuka Djibouti, National Bank of Georgia
Alex Vinueza, Central Bank of Ecuador
Labinot Lekaj, Central Bank of Kosovo
Gian Luca Trequattrini, Banca d'Italia
Ana Krsmanovic, Central Bank of Montenegro
Robert Cornelisse, De Nederlandsche Bank
Michael Steenbakker, De Nederlandsche Bank
Erik Schoonen, De Nederlandsche Bank

TABLE OF CONTENTS

Abstract.....	2
I. Introduction.....	4
II. <u>The internal audit of Central Bank Governance: key concepts and connections.....</u>	<u>6</u>
1. Governance	
2. Internal control framework	
3. Risks of poor governance	
4. Internal audit	
5. (Corporate) governance audits	
6. Conclusion	
III. <u>Governance audit at CBA.....</u>	<u>15</u>
A. In the beginning	
B. Underpinnings in literature	
C. Overall objective of the audit	
D. Approach and methodology of the audit	
E. Scope of the audit	
IV. <u>Outcome of the audit.....</u>	<u>28</u>
V. <u>Lessons learned.....</u>	<u>29</u>
VI. <u>Conclusion.....</u>	<u>31</u>
 Annex 1: Survey used during the audit.....	 32
Annex 2: Glossary.....	32

I. INTRODUCTION

1. Central banks play a pivotal role in the stability and credibility of their countries' monetary and financial systems, and their internal governance is thus a matter of utmost importance. In these current times of "fiat money," our monetary systems are basically based upon trust. Indeed, "the soul of money is trust¹." Trust that the monetary arrangements are well designed, trust that money will be issued in accordance with sound and transparent principles, and trust that money will be issued by safe and sound monetary institutions. The latter is critical, because "ensuring trust is difficult and calls for strong institutions – an appropriate "institutional technology". Central banks have evolved to become key pillars of the whole edifice, alongside banking regulatory and supervisory authorities – often central banks themselves²." For central banks to be perceived as such strong and credible institutions, they must display strong governance.
2. The new Global Internal Audit Standards (GIAS) of the Institute of Internal Auditors (IIA) emphasize the important role internal audit plays as the cornerstone for governance and steps taken to evaluate and improve governance frameworks³. The GIAS stress that internal audit should be a trusted advisor in recognizing risks and opportunities regarding governance, with the view towards promoting transparency and accountability. The internal audit function is thus an integral and transformative contributor to good governance within any sophisticated institution, including a central bank⁴. Its core mission goes far beyond a mere superficial examination; it seeks to be the driving force behind an organization's commitment to good governance and adequate risk management. At its heart, internal audit is intrinsically concerned with the very essence of governance. Internal audit goes beyond identifying deficiencies and recommending solutions, positioning itself as a catalyst for positive change. Through this proactive and collaborative approach, it strengthens governance, risk management, and control processes, supporting the central bank's mission while safeguarding its integrity and credibility. Traditionally, the internal audit function plays an enabling role in governance through its work—but should it audit governance itself? A sound internal audit framework will ensure that the audit effort focuses on the main risks for the central bank, underscoring the link with the risk management framework. This in turn is best anchored in the broader organizational strategy of the central bank. Most central bank internal audit departments will spend significant effort in auditing the cash issuance, financial operations, information technologies, payment system and human resource management functions. Much less common, however, is the audit of governance itself.
3. In this context, this paper seeks to share the experience of the Central Bank of Armenia (CBA)'s Internal Audit team in performing its first bank-wide governance audit, in 2023. This experience was unique, not only because it marked the first of its kind in the institution, but also because it unfolded amidst the bustling backdrop of internal reforms and organizational shifts. Specifically, the CBA's transformation driven by the adoption of a new strategy triggered the urgency for conducting a governance audit. Moreover, the new CBA strategy prioritizes the development of governance-related capacities.

¹ Digital currencies and the soul of money, Speech by Mr Agustín Carstens, General Manager of the BIS, Goethe University's Institute for Law and Finance (ILF) conference on "Data, Digitalization, the New Finance and Central Bank Digital Currencies: The Future of Banking and Money", 18 January 2022. Digital currencies and the soul of money (bis.org)

² Claudio Borio, *On money, debt, trust and central banking*, BIS Working Papers No 763, 2019.

³ The Institute of Internal Auditors (IIA), Global Internal Audit Standards, 2024.

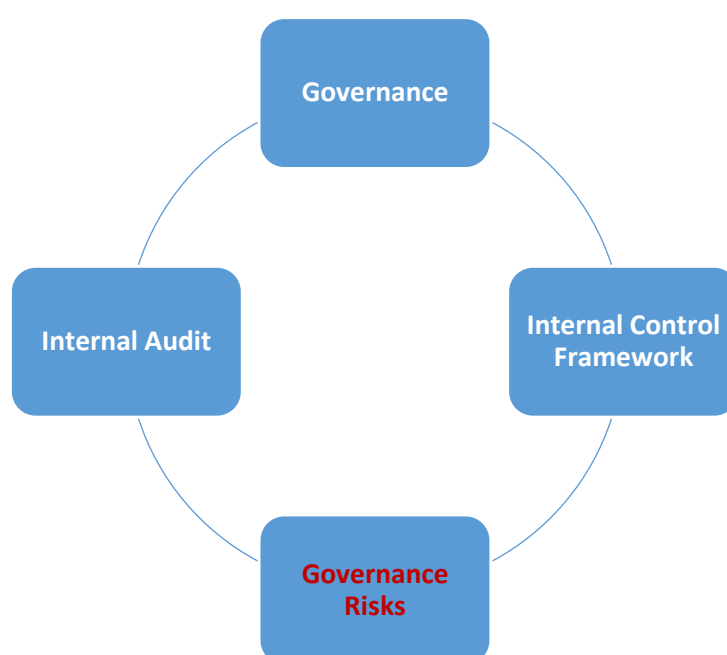
⁴ This significance was underscored more broadly by the IIA Position Paper titled "Internal Auditing's Role in Corporate Governance." Internal audit provides objective assurance and insight on the effectiveness and efficiency of risk management, internal control, and governance processes, provoking positive change and innovation within the organization. A vibrant and agile internal audit function can be an indispensable resource, supporting sound corporate governance.

4. This paper is addressed to a twofold audience. First, through a combination of general insights and practical experience, this paper primarily seeks to assist central bank internal auditors in developing a comprehensive audit program for auditing their central bank's governance. The authors hope that the paper can serve as a benchmarking tool for other central banks' internal audit departments to deploy the methodology and thus further strengthen it. When the authors started their governance audit, they delved into a significant amount of literature on governance and governance auditing. However, most of this literature was theoretical in nature and lacked practical insights, making it challenging to develop an actionable audit program. As a result, the CBA's audit team decided to create its own methodologies for various focus areas, as outlined below. These methodologies can be adapted by internal audit departments of other central banks to suit their specific needs and characteristics.
5. To that end, the paper will delve into the application of agile auditing and providing a comprehensive toolkit for auditing central bank governance efficiently. The paper will cover a range of specialized tools and techniques that were specifically designed by the CBA's Internal Audit team. For instance, it offers tools for assessing the quality of decision-making processes and management information, underscores the importance of evaluating committee materiality through the introduction of a novel assessment model, and showcases how agile auditing methods can be effectively put into action.
6. Secondly, the paper is also written to assist senior executive and non-executive leadership of central banks that are contemplating embarking upon a governance audit of their institution. This is particularly pursued by contextualizing the main findings of the paper in a broad conceptual introduction. The authors look forward to receiving feedback from internal auditors, executives, and Board members from other central banks.
7. This paper is subject to a number of caveats. First, when it comes to many aspects of central banks internal governance, there is no one-size-fits-all solution. What works for one central bank might not work for another, due to differences in size, culture, and other variables. Thus, the principles and practices of an internal audit of governance need to be adapted to the specific needs and circumstances of each central bank. Secondly, the field of internal audit is dynamic, with regulations, technologies, and business environments constantly evolving. As a result, internal auditors must engage in continuous learning to stay up to date with these changes. This continuous learning involves professional development, attending relevant training and conferences, and actively seeking knowledge and skills to improve their audit practices. Third, effective internal audit is not a one-time process; it is an ongoing and iterative activity. It involves creating a feedback loop where audit findings and recommendations are shared with the organization's management and stakeholders. This allows for open communication and the opportunity to address issues and make improvements based on audit results. It is a two-way street where management provides feedback to internal auditors as well, helping them refine their audit approach and focus on areas of highest concern to the organization.
8. The remainder of the paper is as follows. To prepare the reader, the next section will introduce and connect the key concepts relevant to the internal audit of central bank governance. The third and main section will discuss in considerable detail the approach followed by the CBA's audit team in its governance audit. The fourth section will summarize the key findings (at a level of generality that maintains confidentiality). Section five will draw lessons from the experience. A final section will conclude.

II. THE INTERNAL AUDIT OF CENTRAL BANK GOVERNANCE: KEY CONCEPTS AND CONNECTIONS

9. Before diving into the specifics of the CBA's governance audit, it is necessary to briefly discuss and connect the core concepts that underpin this endeavor. For any central bank's internal audit department to commence auditing its institution's governance, it is imperative to have an adequate understanding of the scope (what) and purpose (why) of the audit. Therefore, the concepts of "governance," "internal controls," "risks of governance," and "internal audit" require definition and description, especially in the idiosyncratic context of central banking. The connection between those concepts is reflected in Figure 1.

Figure 1. Connection between governance, internal control framework, governance risks and internal audit



- **Governance** serves as the foundation, defining the principles, structures, and processes for effective decision-making and oversight within the organization.
- **Internal control** is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance⁵. Deficiencies in this framework, such as lack of policy clarity or ineffective controls, can lead to **governance risks** by undermining accountability and operational effectiveness.
- **Governance risks** arise when there is a lack of transparency, accountability, and ineffective governance structure, leading to poor decision-making and regulatory non-compliance. They also emerge when **internal controls** are weak, stakeholder interests are ignored, and unethical practices become normalized, resulting in financial losses, reputational damage, and operational inefficiencies.
- **Internal Audit** independently assesses the effectiveness of both **the governance processes and the internal control framework**. It identifies control deficiencies and

⁵ COSO, *Internal Control – Integrated Framework*

assesses risk management practices. In addition, internal audit provides practical recommendations to mitigate governance risks and strengthen controls, fostering continuous improvement throughout the organization.

- **Governance audit** provides a broader assessment of governance structures and processes, evaluating their ability to address risks and support the effective delivery of the CBA's mandate.

Together, these elements form a cohesive system where governance, controls and internal audit, interact to promote accountability and resilience. Further in this section, we will explain components of Figure 1 both in a general context and in the context of central banks.

GOVERNANCE

In General

10. Governance is a complex concept without a unified definition. For instance, while the OECD's Principles of Corporate Governance provide attributes of governance, they do not provide a definition⁶. In a private sector environment, "corporate governance" has been defined as "the system by which companies are directed and controlled" (1992 UK Corporate Governance Code). Another definition states that governance "encompasses the system by which an organization is controlled and operates, and the mechanisms by which it, and its people, are held to account. Ethics, risk management, compliance and administration are all elements of governance⁷." According to the IIA, corporate governance is the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives⁸. ISO in turn defines corporate governance within the broader context of organizational governance, as outlined in ISO 37000:2021. This standard provides principles and practices to help governing bodies fulfill their responsibilities, ensuring that organizations can achieve their purpose and generate long-term value for stakeholders.
11. At any rate, good governance follows a set of well-established general principles. These principles advocate for decision-making to be both sound—geared toward the objectives of an organization and in compliance with rules and regulations—and effective—the necessary decisions are taken, at the right time. The four most important of those principles are the following:
 - **"No Gaps, No Overlaps"** – The governance of any mature organization operates through one or more decision-making bodies, each of which acts in the name and on behalf of the organization. This requires that all decision-making roles and responsibilities must be clearly allocated to the appropriate decision-making body, without gaps, but also without overlaps. If not, governance arrangements will be vulnerable to gaps and conflict.
 - **"Unity and consistency"** – Organization's decision-making bodies must each individually, and also collectively, be unified—as opposed to fractured: an organization's decision-making must be "one and indivisible."

⁶ OECD Principles of Corporate Governance

⁷ Governance Institute of Australia.

⁸ IIA, o.c., 2024

- **“Checks and Balances”** – The concept of “checks and balances” within this framework prevents the concentration of power, introducing oversight mechanisms to ensure accountability, transparency, and balanced decision-making across the organization. By distributing authority across different entities or levels, checks and balances introduce a system where each entity serves as a check on the others, thereby minimizing the likelihood of unchecked authority or unilateral decision-making. This approach fosters a framework where actions, decisions, and policies undergo scrutiny and validation, promoting a more robust and balanced functioning of organizations, governments, and organizational hierarchies.
- **“Integrity of Chain of Command”** – This principle, which as its name suggests originates in the military, entails that “command and control” structures must follow the established hierarchy. A breach of this principle weakens decision-making by disempowering parts of the chain of command—thus leading to mistrust—as well as the risk that the most competent person or entity is not included in the process. In combination, this undermines the cohesion of institutions.

In a Central Bank Context

12. Central bank governance more specifically can be defined as the ensemble of structures and arrangements by means of which a central bank makes decisions, in the pursuit of its mandate⁹. While the private sector follows a narrower approach focusing on decision-making structures specifically, the literature takes a more expansive conceptual view in regard of public institutions, and central banks specifically. In particular, even though this latter view certainly also homes in on decision-making structures (sometimes labelled “internal governance”), it also emphasizes the broader contextual elements, such as the role of the mandate, autonomy, accountability and transparency¹⁰. The relevance of this definition can be illustrated by considering the above-mentioned governance principle of “no gaps, no overlaps.” For a typical private law organization (e.g., a company), this principle requires a clear allocation of the decision-making responsibilities of executive management and oversight. But for central banks, who have the public law mandate to formulate monetary policy and often also to regulate and supervise banks and other financial institutions, this additionally requires consideration of their decision-making responsibilities for monetary policy formulation and regulatory decision-making¹¹. In that light, the fundamental question thus arises whether a governance audit of central banks should audit governance in the narrow or broad sense. In the context of the Central Bank of Armenia, governance broadly refers to the Board, Governor, and relevant permanent committees. Together, these components form a framework through which Central bank of Armenia fulfills its mandate for effective governance.
13. For the purpose of this paper, “governance” is really shorthand for “decision-making structures and processes,” i.e. “internal governance.” In principle, it is possible to audit governance in the broad sense of the word, but the problem is that such an audit by definition will also be concerned with the relationship between the central bank and the political institutions. This may raise challenges in terms of access to information and buy-in from stakeholders. A more pragmatic and practical choice is therefore to focus initially on internal governance, as this allows confining the audit to the central bank itself and matters that are largely under its control. This was the choice made by the CBA. Internal

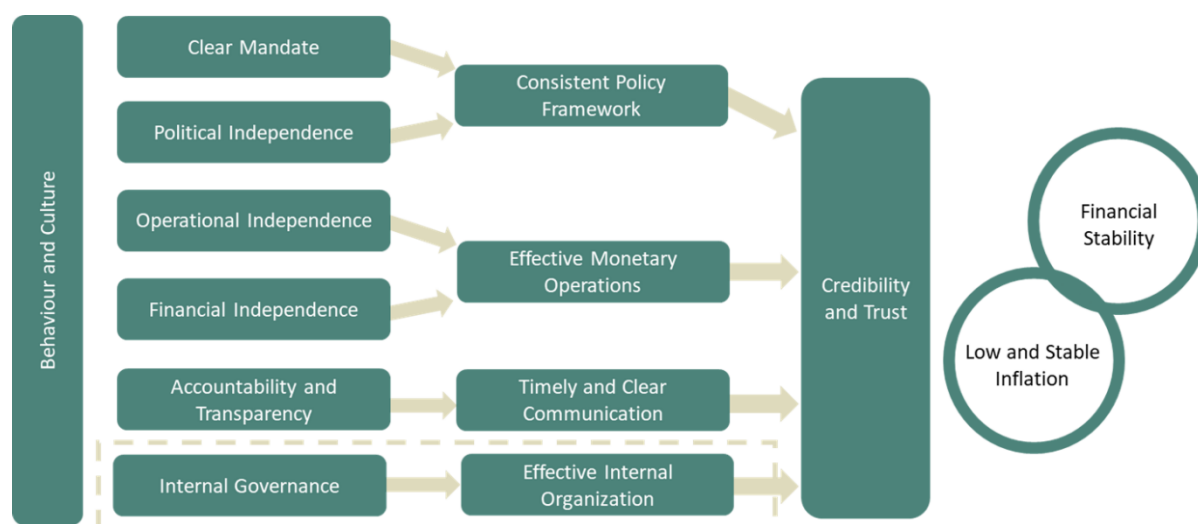
⁹ Bossu, W., and Rossi, A., *The Role of Board Oversight in Central Bank Governance: Key Legal Design Issues*, IMF, WP/19/293, para. 12.

¹⁰ Bossu, W., and Rossi, A., o.c., para. 14 and Figure 2; Khan, A., *Central Bank Governance and the Role of Non-Financial Risk Management*, IMF, WP/16/34, pages 5-6.

¹¹ Bossu, W. and Rossi, A., o.c., para. 22 and Figure 5.

governance incorporates all arrangements of the internal organization of the central bank. Clear examples are structure, decision-making processes, risk management arrangements and control mechanisms, and internal audit: everything that influences the decision-making of and within the central bank. The Figure 2 below places this internal governance into a broader governance context¹².

Figure 2. Overview of Central Bank Governance



INTERNAL CONTROL FRAMEWORK

In General

14. The most authoritative international standard - COSO Internal Control – Integrated Framework¹³ - defines the internal control framework as “a process, effected by an entity’s Board of Directors, executive management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.” This standard specifies that internal control has five components: the control environment, risk assessment, control activities, information and communication, and monitoring activities. The first and third component merit some further consideration.
15. Governance acts as the cornerstone dictating objectives and strategies, orchestrating the structure within which internal controls function. These controls draw their strength from the robustness of governance. Under the COSO framework, governance essentially constitutes the core of the control environment, which is defined as “the set of standards, processes and structures that provide the basis for carrying out internal control across the organization¹⁴.” A well-structured governance system not only delineates responsibilities

¹² Khan A., o.c.

¹³ See COSO, Internal Control – Integrated Framework Executive Summary. Executive Summary (coso.org)

¹⁴ In the COSO Framework, five of the seventeen Principles (representing the fundamental concepts associated with the components) concern the “control environment.” One of those requires the Board of Directors to exercise independent “oversight of the development and performance of internal control.” Another Principle provides that executive management must “establish under Board oversight structures, reporting lines and appropriate authorities in the pursuit of objectives.”

and authority, but also cultivates a culture of adherence: internal controls, reliant on robust governance, ensure policy adherence and risk mitigation.

16. Within this relationship, entity-level controls establish the overarching control environment, setting the tone at the top and delineating the broader governance structures, while activity-level controls focus on granular transactions and operational procedures. Together, they reinforce the governance framework, amplifying risk management and compliance efforts. The establishment of internal controls involves tailored design, implementation, and integration into the operational fabric, while ongoing oversight and monitoring adapt these controls to evolving risks and regulatory changes.

In a Central Bank Context

17. Due to their specific nature of policy body (“central”) and financial institution (“bank”), the internal control framework of central banks poses specific challenges. Unfortunately, the literature on this issue is scarce. The most specific and concrete development can be found in the IMF’s policy papers underpinning the elaboration of the Safeguards Assessment Policy¹⁵. Under this policy, IMF staff assesses central banks of borrowing members with a view to provide reasonable assurances to the IMF’s Executive Board and management on risks for misuse of IMF financing and misreporting of relevant information to the IMF. These assessments follow the so-called GELRIC framework, whereunder C stands for “internal controls¹⁶.” The IMF staff does not review the entire internal control framework of the central bank in that context, but focuses rather on those controls that are most relevant for the risk of misuse or misreporting. In that regard, the IMF notes that “(t)he objective in assessing internal control systems is to determine whether appropriate procedures are in place, at all levels, to provide reasonable assurance that material risks that could adversely affect the central bank’s operations are being continuously recognized, assessed, and mitigated. The main focus is on controls over the banking, accounting and foreign exchange operations of the bank¹⁷.”

RISKS OF POOR GOVERNANCE

In General

18. Poor internal governance often directly contributes to internal control deficiencies that jeopardize an organization's effectiveness, credibility, and stability. Governance weaknesses encompass poor decision-making processes, inadequate oversight structures, unclear roles and responsibilities, fractured executive management, and ineffective risk management protocols. Weak internal controls create a breeding ground for poor governance practices and amplify the risk landscape, potentially leading to systemic failures and regulatory misconduct. Addressing poor governance thus becomes critical as it directly impacts the reliability and strength of internal controls within an institution's operations.

In a Central Bank Context

19. The major internal control risks associated with inadequate governance at central banks are discussed in more detail in Box 1.

¹⁵ <https://www.imf.org/en/About/Factsheets/Sheets/2023/Protecting-IMF-resources-safeguards-assessments-of-central-banks>

¹⁶ GELRIC stands for Governance, External audit, Legal framework and independence, financial Reporting, and internal Controls.

¹⁷ Safeguards Assessments – Review of Experience and Next Steps, February 15, 2002 (imf.org)

Box 1: Central Bank Governance Failures and Internal Control Risk

In examining the connection between governance failures and the resulting weak internal controls in central banks, the intricate nature of these failures becomes apparent.

Several publicly reported scandals in which central banks were involved over the past decades illustrate this point. Importantly, such scandals occur not only in countries with well recognized institutional weaknesses (1), but also in advanced economies with sophisticated “checks and balances.” For instance, in one G7-central bank, senior leaders had to resign after it was divulged that they had taken positions in the financial markets that could benefit from their role in interest rate setting. (2) In another G7-central bank, a scandal involving a very dominant governor exposed a lack of stringent internal controls that could have curbed his alleged favoritism in bank takeovers. (3)

Whilst in some cases the main impact of the governance failures consists of reputational damage, in many other cases the link with internal control breakdowns is so direct that the central bank becomes subject to financial losses, often combined with manipulation of the financial statements to hide the misuse of central bank assets. Even if the impact is not that significant, the central bank can suffer from major fallout in the form of ineffective management or failure to achieve objectives. The following table will seek to map systematically the main governance failures to the typical ensuing or related internal control risks. This table will illustrate that the absence of effective internal checks and balances often leads to issues such as financial irregularities and lack of transparency.

Importantly, the table does not only seek to point out how weak governance can translate in major internal control risks, but also makes the converse point that strong internal control frameworks are essentially the litmus test for robust governance: if a sound governance set-up does not materialize in a strong internal control framework (due to more hidden, underlying factors such as culture), the achievement is merely theoretical and not practical.

The following table aims to systematically map, though not exhaustively, the main practical governance failure examples to their corresponding or related internal control weaknesses.

Governance Failures	Internal Control Risk
Lack of Accountability and Oversight	
Excessive concentration of power combined with weak checks and balances	- Internal control overrides especially in the form of: - Misappropriation of funds - Manipulation of financial records
Weakened compliance with laws and regulations	- Legal penalties - Reputational damage - Operational disruptions
Ineffective risk management	- Unaddressed vulnerabilities - Impact on operations and objectives
Silos and Information Barriers	
Hindered cooperation and communication between departments	Lack of information sharing leading to incomplete perspectives
Duplication of efforts and resources	Wastage of resources due to redundant or overlapping tasks
Inconsistent or conflicting information	Errors or misinterpretation due to conflicting data
Reduced collaboration and innovation	Missed opportunities for cross-functional collaboration
Poor Decision-Making Processes	
Decisions not aligned with organizational goals	Risk of deviating from strategic objectives
Inadequate risk assessment before decision-making	Increased exposure to unforeseen risks
Absence of transparent decision-making procedures	Difficulty in assessing decision rationale
(Perception of) Impulsive or biased decision-making	Higher likelihood of errors, biases, or flawed judgments

(1) [Albanian court clears ex-central bank governor of abuse charges | Reuters](#); [Burundi's sacked central bank chief arrested over money laundering accusations \(bbc.com\)](#)

(2) [Kaplan and Rosengren, Fed Presidents Under Fire for Trades, Will Step Down - The New York Times \(nytimes.com\)](#)

(3) [Amid Inquiry, Chief of Italy's Central Bank Resigns - The New York Times \(nytimes.com\)](#)

INTERNAL AUDIT

In General

20. According to the definition of the IIA¹⁸, “internal auditing is an independent, objective assurance and advisory services designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.” Internal audit is thus like having a team of independent professionals inside your company who act as your eyes and ears¹⁹. They assess controls, risks, and overall governance to identify not just areas for improvement, but also potential weaknesses that could expose the company to fraud, errors, or missed opportunities. By examining how things are done, they recommend ways to ensure compliance and reliable information, protect assets, manage risks better, and ultimately help the company achieve its goals without unnecessary bumps in the road. A strong internal audit function is indispensable for strong governance as it helps organizations manage risks, ensure compliance, maintain transparency, and continuously improve its operations.

21. Turning to the key attributes highlighted in the IIA definition:

- **Independence** in internal auditing refers to the organizational arrangements to ensure the autonomy and freedom from undue influence in conducting evaluations. Ensuring operational independence in internal audit is critical to maintaining the integrity and effectiveness of the audit function. Organizational independence is effectively achieved when the chief audit executive reports functionally to the Board of Directors, typically through the Audit Committee. This includes approving the internal audit charter, a risk-based internal audit plan, the internal audit budget and resource plan, etc.
- **Objectivity** is linked to how internal auditors need to be able to approach assessments and evaluations without personal bias, prejudice, or influence. Internal auditors aim to present a fair and unbiased analysis of the organization's operations. They base their assessments on evidence, facts, and a systematic evaluation of processes, rather than personal opinions or external pressures.
- **Adding value** through internal auditing involves more than just identifying issues or pointing out deficiencies; it is also about providing insights, recommendations, and solutions that enhance the effectiveness and efficiency of an organization's operations. Internal auditors offer suggestions for improvement, risk mitigation strategies, and opportunities to optimize processes, ultimately contributing to the organization's overall success. Internal auditing seeks to enhance various facets of an organization.
- By evaluating **risk management, control mechanisms, and governance processes**, auditors help identify weaknesses or inefficiencies. Through their recommendations, they enable the organization to strengthen these areas, reduce risks, ensure compliance with regulations, and enhance overall performance and achievement of objectives.

22. The GIAS, effective January 2025, establish a consistent framework to enhance internal audit practices worldwide. Compared to the 2017 standards, the new framework

¹⁸ <https://www.theiia.org/en/standards/what-are-the-standards/definition-of-internal-audit/>

¹⁹ Internal audit is often viewed through the “three lines” model, with operational management managing risks (first line), risk management and compliance providing control (second line), and internal audit offering independent assurance (third line). Criticisms include unclear roles, lack of motivation and expertise, and friction between lines. The IIA's updated Three Lines Model now emphasizes collaboration and shared ownership of risk management, removing the “defense” terminology.

introduces more explicit guidance on governance processes, greater focus on risk-based auditing, and increased emphasis on agile auditing methods that align with evolving regulatory and operational landscapes. This shift is designed to empower auditors to deliver deeper insights and add greater strategic value to organizations.

In a Central Bank Context

23. Internal audit is an evolving phenomenon in central banks. Previously, most central banks had “inspections departments” that would provide (essentially some type of compliance) inspections in high-risk activities of central banks, especially currency issuance. Today, most central banks have some form of internal audit function. Applying the general principle, also for central banks the internal audit function’s role is to provide independent assurance to the Board and senior management on the quality and effectiveness of the central bank’s risk management, internal control, and governance systems and processes²⁰. This said, many central banks struggle to make most of the function²¹.

(CORPORATE) GOVERNANCE AUDITS

In General

24. Governance audits consist of evaluation of an organization's governance structure and practices. They provide a comprehensive analysis of existing strengths, weaknesses, compliance gaps, and inefficiencies within governance mechanisms. For instance, such audits substantiate an organization's integrity by scrutinizing transparency and accountability across its operations and maintaining trust among stakeholders. They also act as a compliance checkpoint, ensuring that the organization aligns with legal and regulatory mandates, thus mitigating potential risks of legal repercussions or reputational damage. Moreover, governance audits pinpoint inefficiencies, enabling strategic refinements that optimize processes, resources, and decision-making, thereby fortifying the organization's overall effectiveness. Crucially, these audits act as a safeguard against unethical practices, fraud, or misuse of power, fostering an environment of ethical conduct and integrity. By bolstering risk management and proactive identification of potential pitfalls, governance audits play a pivotal role in steering organizations towards sustained success and resilience in today's complex landscape. Such audits are essential for complex and large organizations to maintain their credibility, ensure compliance with legal frameworks, improve efficiency, and prevent abuses of power.
25. Governance audits yield invaluable insights crucial for catalyzing reform. Such a diagnostic evaluation can become the cornerstone for reform initiatives, supporting enhancement and evolution. The outcomes of such an audit can act as a compass, guiding policy and procedural reforms, addressing identified weaknesses, fortifying compliance adherence, and bolstering transparency and accountability. These reforms often encompass reshaping decision-making structures and processes, fortifying stakeholder engagement, and bolstering data governance, ensuring that the reforms not only rectify current issues but also cultivate a culture of continual improvement and adaptability. Thus,

²⁰ Chamoun, E., and Van Greuning, R., Effectiveness of Internal Audit and Oversight at Central Banks: Safeguards Findings – Trends and Observations, IMF, WP/18/125 Effectiveness of Internal Audit and Oversight at Central Banks: Safeguards Findings - Trends and Observations (imf.org)

²¹ Ibid.

the link between the outcomes of a governance audit and subsequent reforms is pivotal, not just for rectifying existing deficiencies but also for fostering a resilient, transparent, and effective governance framework poised for the challenges of the future. In a Central Bank Context.

26. The relevance of governance audits for central banks must be considered against the backdrop of how central banks go through reform. As has been illustrated in Box 1 (page 9), complacency in central bank internal oversight can lead to serious governance breakdowns and internal control failures, including at sophisticated central banks. When that occurs, the political institutions' habitual reluctance to interfere in central bank governance disappears in the face of scandal or crisis, and politicians then impose reforms on the central bank. Sometimes the effects of this reform can be beneficial, but that is far from guaranteed. Therefore, central bank governance bodies have a strong incentive to maintain the initiative and review their own governance from time to time, on their own terms, when all is calm. With its profound knowledge of the organization, internal audit is extremely well-placed to provide such a review, which can serve as a catalyst for internal reform when needed. Of course, this does not exclude external consultation with government and other stakeholders —this is indeed an essential ingredient of any deep central bank reform—but it has the advantage that the central bank maintains the initiative to detect weaknesses and design well-informed solutions under normal circumstances.

CONCLUSION

27. In sum, the internal audit function should not only contribute by auditing activity-level controls, but also by auditing the control environment and entity-level controls. Governance audits are the ideal instrument for that. This is valid for any sophisticated organization, including central banks.

III. GOVERNANCE AUDIT AT CBA

28. This section will present the 2023 comprehensive governance audit of the CBA in a degree of detail that makes it useful for other internal auditors seeking to audit the internal governance of their central bank. The section will share the audit's beginnings, its underpinnings in literature, its overall objective, its methodology, and its scope.
29. The governance audit conducted by the CBA was completed under the 2017 audit standards, as the timing of the audit (2023) preceded the release of the new GIAS.

A. IN THE BEGINNING...

30. In the beginning, a question arose during a routine internal audit meeting at the CBA: should we also audit the central bank's governance itself? This simple question sparked a series of discussions that led the CBA audit team to consider the idea of conducting a dedicated governance audit. While various aspects like cash issuance, IT, and financial operations are systematically audited, the CBA's internal audit rarely focused on the overarching governance framework of the central bank. Although governance can be considered in each engagement, there remains a need for a comprehensive, bank-wide governance focus. Upon further analysis, it became obvious that many of the root causes of issues were tied to governance-related problems, which strongly motivated the audit team to pursue a governance audit. Additionally, insights gained from a recent "culture" audit highlighted several areas that required a deeper examination of our governance structures, emphasizing the need for a comprehensive review.
31. It is an interesting exercise for audit teams to map findings from governance audit to cultural environment of the organization. In our case, the audit of culture was conducted prior to the governance audit with a focus on alignment between the Central bank's desired and actual culture. In several instances, the identified misalignment was closely related to conditions highlighted in the governance audit. Examples of these relationship were between perception of accountability and reporting, clarity of expectations and up to date policies, desired behavior acknowledgement and assignment completion.
32. The idea gained traction as the audit team saw the potential impact it could have on strengthening the institution's governance practices. The Board's interest in governance controls amid internal reforms further reinforced the need for such an audit. Additionally, the CBA's new strategic direction emphasized the development of governance-related capacities, adding more weight to the idea.
33. The governance process of CBA also is encompassed within the internal audit universe. This universe includes the various processes that are evaluated by the Board and senior management during the annual risk assessment, which precedes the creation of the annual audit plan. The governance process, assessed by the Board and senior management using the CBA's established risk factors, was incorporated into the draft audit plan based on its risk rating and subsequently approved by the Board.
34. Looking back, the genesis of the governance audit was a natural progression driven by necessity, and a desire for continuous enhancement. It exemplifies the CBA's internal audit's commitment to evolving with the changing landscape of central banking and underscores the importance of introspection and innovation in its audit practices.

B. UNDERPINNINGS IN LITERATURE

35. Establishing the literature that underpinned the governance audit was a challenge. While a lot of literature explains what governance is and why it matters, there is a big gap when it comes to actually showing how to audit it, especially in the unique setting of central banking. This is why the authors seek to publish this paper. This said, there are several publications which the authors used while planning for this audit. Specifically, we had recourse to the following literature:

- International Monetary Fund, WP19/293, “The role of board oversight in central bank governance: Key legal design issues”
- International Monetary Fund, WP16/34, “Central bank governance and the role of non-financial risk management”
- G20/OECD, Principles of corporate governance
- OECD Corporate governance working paper No. 24, The role of board-level committee in corporate governance
- Bank for International Settlements, Basel Committee on Banking Supervision “Corporate Governance Principles for Banks”
- The Institute of Internal Auditors “Guiding Principles of Corporate Governance”
- The Institute of Internal Auditors “Global Advocacy Platform”
- The Institute of Internal Auditors “Three lines model”
- International Organization for Standardization “Governance of organizations, guidance”, ISO 37000 Standard
- KPMG, “Governance of Central banks”
- Deloitte, “Auditing Governance: Having a voice where it counts.”

Building upon the valuable insights outlined in the referenced literature, the methodologies discussed below offer practical steps and tools tailored to assess governance within the unique context of central banking, aiming to fulfill the unmet need for actionable guidance highlighted earlier.

C. OVERALL OBJECTIVE OF THE AUDIT

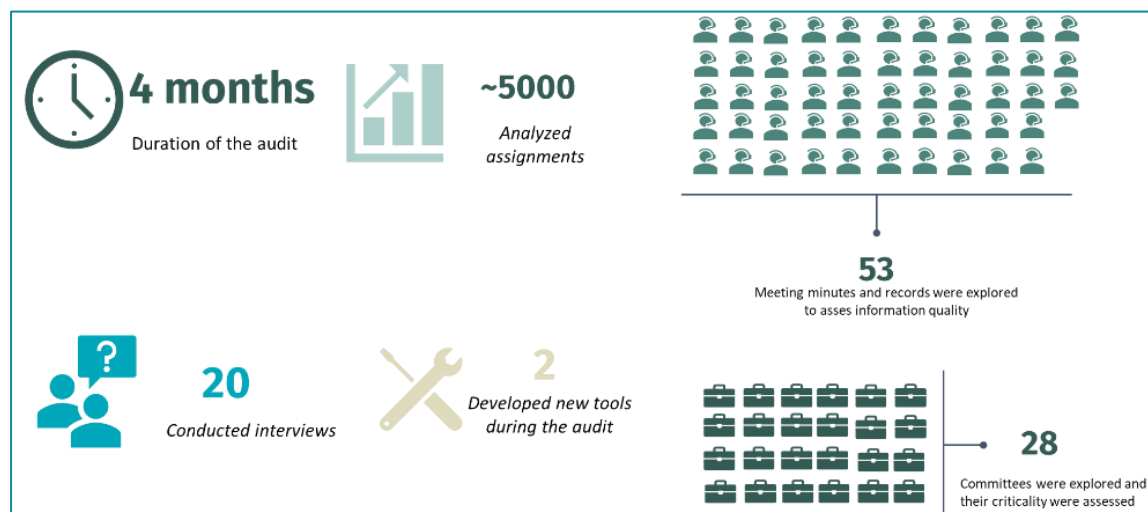
36. The overarching objective of the governance audit was to (a) confirm the existence and efficient functioning of the processes and procedures for decision-making, and (b) pinpoint any deficiencies or opportunities for enhancement in the internal governance framework. Essentially, the governance audit sought to provide assurance that the internal governance framework of the CBA was not only established, but also operating effectively in alignment with the organization's mission and goals.

D. APPROACH AND METHODOLOGY OF THE AUDIT

37. The audit team was diverse, consisting of 3 auditors from both the operational audit and IT audit divisions. The operational auditors held the Certified Internal Auditor (CIA) designation, while the IT auditor was a Certified Information Systems Auditor (CISA). During the course of the audit, the IT systems supporting governance processes, particularly those related to document flow and assignment controls, were thoroughly examined. This examination focused on multiple critical aspects, including data management and accuracy, information security, and IT general controls. The team's expertise ensured a comprehensive evaluation of both operational and technological dimensions, contributing to the overall integrity and reliability of the governance

framework. See more details below in box 2. It is worth noting that another factor contributing to the audit was the Chief Audit Executive's past experience as Deputy Secretary General of the Central Bank of Armenia.

Box 2. Statistical Numbers of the Audit

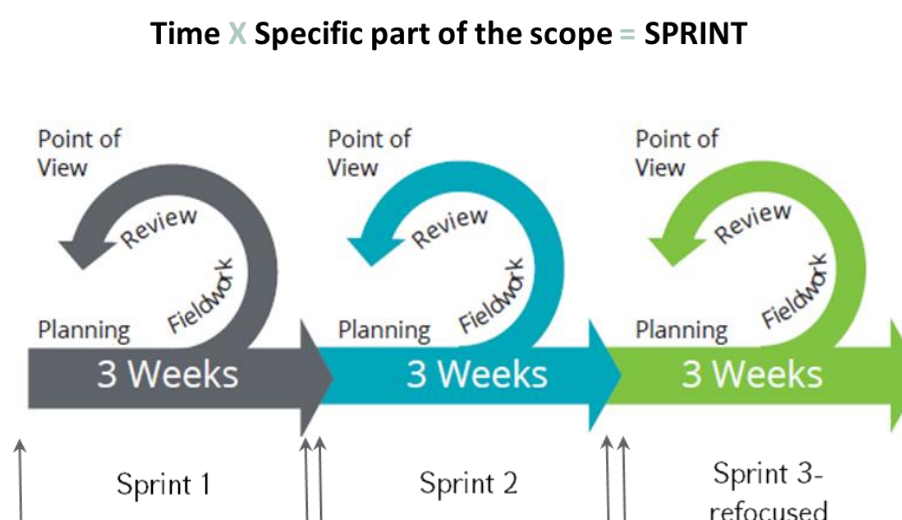


38. The audit team effectively expanded the use of data analytics to enhance the evaluation of governance practices. Analytical tools were utilized to identify trends, patterns, and anomalies, providing insights that added significant value to the findings and recommendations.
39. The approach of this audit engagement was agile auditing. Agile auditing emerged as a transformative approach in internal auditing, inspired by software development principles. It emphasized continuous improvement, stakeholder engagement, and delivering timely insights. Unlike the traditional approach to audit, agile auditing adopted an iterative process with flexible sprints, allowing for constant adjustments based on findings. This fostered collaboration and understanding, resulting in streamlined documentation and potentially improved efficiency, communication, and audit quality. However, successful implementation required addressing organizational culture, mindset, and skillset challenges. To audit in an agile way, it is necessary to overcome these challenges to achieve collaboration, adaptability, and shared commitment to continuous improvement. Matching these elements can help audit teams effectively embrace agile principles that will contribute to responding more quickly to emerging risks, streamlining processes, and improving stakeholder engagement.
40. This approach signified a shift towards aligning audit processes with stakeholder needs, expediting cycles, facilitating timely insights, and reducing redundancy through streamlined documentation. It achieved this by embracing agile methodologies and various audit tools, such as data collection, analysis, interviews, and observations. Subsequent sub-sections will delve into the diverse toolkit employed to achieve goals. Each testing goal within distinct focus areas was meticulously addressed through the application of tailored tools. By employing this diverse toolkit, auditors could tailor their approach to address specific testing goals within different focus areas. The emphasis on tailored tools ensured that audit efforts were focused and resource-efficient, minimizing redundancy and maximizing the value delivered to stakeholders. Overall, this approach represented a significant departure from traditional audit practices, reflecting a

commitment to agility, responsiveness, and continuous improvement in the audit profession

41. One key aspect that should be highlighted is the division of the audit scope into manageable “sprints.” In the context of agile project management, sprints refer to short, time-boxed periods during which specific tasks or objectives are completed. This approach can also be followed mutatis mutandis by audit. Specifically, by breaking down the audit scope into smaller, more manageable segments, auditors could focus on delivering tangible results within a shorter timeframe. This underscored the potential of agile methods in enhancing efficiency and responsiveness in internal audit functions. In the context of this paper, a “sprint” thus refers to a time period combined with the specific part of the scope, during which audit work is planned, executed, and initially reported. See Figure 3.

Figure 3. Agile audit scheme



Further in the paper, specific testing targets and testing tools will be introduced for each sprint. In the context of this paper, **testing targets** refer to the specific goal set by auditors for conducting testing procedures during a certain sprint. **Testing tools** refer to the systematic techniques and procedures used to achieve testing targets.

E. SCOPE OF THE AUDIT

42. The CBA’s governance audit comprised five domains²², each of which consisted of several sprints. Together, these five domains covered most of the internal governance function: see below Figure 4. The testing of each of those domains will be discussed in more detail.

²² If governance audits have been conducted multiple times, ESG (Environmental, Social, and Governance) considerations can be included within the scope, depending on the maturity of ESG implementation in the central bank.

Figure 4. Scope of the audit

Governance Policies and Procedures

Testing Targets

43. The target for this domain was to ensure that clear and comprehensive guidelines for internal governance matters were in place. These guidelines typically consist of policies and procedures designed to govern various aspects of organizational operations and decision-making processes. Such guidelines are critical to good governance because they serve as a defined framework for decision-making and action, ensuring consistency and transparency. They establish clear roles and responsibilities, thus streamlining operations and promoting accountability. By proactively outlining expected behavior and potential pitfalls, they reduce risks and enhance transparency and communication, fostering trust and understanding. The absence of such guidelines can lead to a multitude of negative consequences. Decisions may be arbitrary or inconsistent, causing confusion and frustration. Unclear roles and responsibilities can hinder accountability and efficiency, making organizations more susceptible to risks like fraud and misconduct. Additionally, transparency and communication may suffer, potentially eroding trust and stakeholder confidence. In that light, the audit sought to thoroughly examine both the substance and implementation of the established guidelines related to governance matters.
44. On substance, the specific purpose was to assess the extent to which these guidelines were in harmony with (i) industry standards, (ii) organizational strategy, and (iii) legal obligations. This involved a detailed analysis of the language and specifics of the policies.
 - The alignment with industry best practices ensures that the organization is benchmarking itself against broader industry standards, striving for excellence. For a central bank, aligning with industry best practices means comparing its policies and operations with those of other central banks globally. This helps enhance credibility, manage risks, and ensure effective governance. By learning from the experiences of other central banks, the institution can adopt successful strategies and avoid pitfalls. Following these practices

enables the central bank to adapt to changes more effectively, foster innovation, and facilitate global cooperation.

- The evaluation of alignment with organizational strategy ensures that governance is not a detached function, but an integral part of the overarching organizational objectives. The CBA's strategy included "Governance" as a strategic direction, indicating the central bank's intention to undergo a strategic transition towards "values-driven, outcome-based management"²³ to enhance flexibility, effectiveness, and responsiveness. This includes empowering teams, implementing project management, data-driven decision-making, and aligning subsidiaries with the bank's vision. Key features are flexible structures, collegial decision-making, responsible leadership, and improved processes with international oversight. The goal is a modern, efficient, and accountable central bank ready to face future challenges.
 - The adherence to legal requirements is a critical aspect to prevent legal complications and maintain ethical standards.
45. On implementation, the assessment of adherence to this triple set of normative objectives throughout the organization was a crucial step. The audit aimed to critically evaluate how well these policies were communicated within the organization and the degree to which they were adhered to by the employees across all levels. The goal here was to go beyond mere documentation and analyze whether these policies were actively communicated throughout the organization. Effective communication channels, training programs, and awareness campaigns were scrutinized to guarantee that all members of the organization were well-informed about the governance guidelines. This sought to ensure that governance was not merely a theoretical concept, but was deeply ingrained in the organizational culture, guiding the actions and decisions of employees at every level.
46. In essence, the audit of this domain aimed to provide a comprehensive evaluation of the governance policies and procedures, encompassing their clarity, practical application, strategic alignment, legal compliance, communication efficacy, organizational adherence and requirement for periodic reviews.

Testing Tools

47. The audit team employed gap analysis and interviews as complementary tools to achieve the abovementioned targets.
48. Gap Analysis. Gap analysis served as a fundamental tool in this testing area, offering a systematic approach to evaluate the alignment between the CBA's internal governance practices and predefined benchmarks. It involved a methodical examination of documented policies against their actual implementation, shedding light on any disparities that may exist. It also involved reviewing documentation to provide assurance that there is a specific requirement for periodic review and update. By benchmarking against industry standards, gap analysis not only identified areas of improvement but also provided a strategic view of how the CBA compared to best practices in the field. This process extended to ensuring legal compliance, detecting any gaps that might exist in meeting regulatory requirements. Furthermore, gap analysis proved invaluable in pinpointing communication breakdowns within the Bank, whether they pertained to training programs, awareness initiatives, or internal communication channels. As a result, it became a comprehensive tool for enhancing and **fine-tuning the governance** framework to meet both internal expectations and industry standards. In addition, the consideration of completeness was performed to obtain an assurance that existing processes are

²³ "CBA strategy", <https://www.cba.am/en/Publication/3957>

regulated and vice versa. This was achieved through a combination of interviews with key stakeholders, a detailed review of regulations, surveys to capture perceptions and feedback, and a thorough examination of relevant documentation.

49. Interviews. Interviews emerged as a powerful qualitative tool to delve into the nuances of organizational practices. By engaging key internal stakeholders, including the Governor, Board members, and others, interviews offered a profound understanding of how governance policies were perceived and understood across various levels of the CBA. They went beyond the surface, exploring the practical implementation of policies through real-world examples and insights provided by those directly involved. In addition, interviews served as a lens to examine the organizational culture's influence on policy interpretation and adherence. This depth of understanding is crucial for effective governance, ensuring that policies not only exist on paper, but are embedded in the daily practices and beliefs of the workforce. Furthermore, interviews provided a platform for internal stakeholders to voice concerns and offer feedback, enriching the audit with qualitative data that complement quantitative findings. The information gathered through interviews became instrumental in crafting targeted recommendations and improvements tailored to the specific needs and challenges identified within the organization.

The Board and Permanent Committees

Testing Target

50. The target for this domain was to ensure that the central bank's collective decision-making structures and their processes were effective, well-structured, and compliant with relevant regulations. The focus was on strategically addressing the risk perspective in the evaluation. Different testing targets were set for each sprint under this focus area.
51. For the **Board's oversight role**, the testing target was to assess whether the Board has effectively executed its responsibility for oversight. By adopting a risk-focused approach, the aim was to provide insights into how well the Board is fulfilling its oversight role and to identify and address potential risks that may impact the central bank's governance effectiveness. Although it is well understood that the Audit Committee is part of the Board's oversight function, the scope of the Governance Audit did not include the Audit Committee, since Internal Audit is closely connected to functioning of the Audit Committee.
52. For the **permanent committees**²⁴, we used two testing targets:
 - The first testing target was to identify inactive committees with substantial materiality. The focus was on assessing the areas these committees were meant to address and determining the reasons for their inactivity. By pinpointing such dormant committees, the audit aimed to mitigate the risk of overlooked critical areas and ensure that decision-making structures are agile and responsive.
 - The second testing target was to identify committees within the central bank, without up-to-date regulation. These cases could pose a risk of non-compliance and lack of transparency. By uncovering such instances, the audit aimed to mitigate the potential risks associated with integrity of the central bank's governance processes.

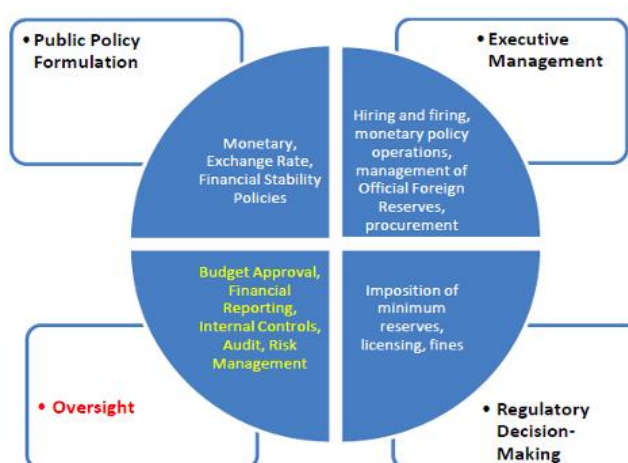
²⁴ Permanent committees are internal committees of the central bank, which are established by the Governor as executive management, and composed entirely of senior leaders and staff of the central bank. Such committees can be either decision-making or advisory. Decision-making committees require explicit delegation of decision-making powers from the Governor.

53. For the **meetings organization and meetings minutes** of both the Board and the permanent executive committees, the testing target was to evaluate the effectiveness of the central bank's meeting processes. This included assessing the organization and structure of meeting agendas and identifying any operational risks inherent in their execution, and examining the authority responsible for setting and confirming the agendas to ensure clarity in decision-making responsibilities. Additionally, the aim was to scrutinize the quality and pertinence of meeting minutes, ensuring accuracy and completeness. The assessment also considered the issue of access to information, focusing on the risk of information asymmetry that could hinder effective decision-making. By adopting a risk-centric approach, the goal was to uncover and address potential operational risks related to meeting organization, contributing to a thorough understanding of how these processes impact the central bank's decision-making and overall governance efficiency. Additionally, management information was also a subject for testing, see details in paragraph 65 - 69.
54. For **delegation of authorities**, the audit placed the emphasis on the risk of inadequate decision-making structures by evaluating the effectiveness of the delegation of authorities within the central bank, especially at the level of executive management. By examining the documented framework, decision-making hierarchy, and associated training initiatives, the audit sought to identify and address any potential risks stemming from gaps in the delegation process. Ensuring clarity, comprehensiveness, and compliance in the delegation of executive authorities was pivotal for mitigating risks associated with decision-making processes within the central bank.

Testing Tools

55. To evaluate the **Board oversight** function, we used mapping and comparison analysis. The testing employed mapping of the actual CBA Board's oversight functions with the provisions of CBA Law. To better understand the completeness of the oversight function additionally, we used "The Role of Board oversight in Central bank Governance" IMF Working paper as a benchmark: see Figure 5.

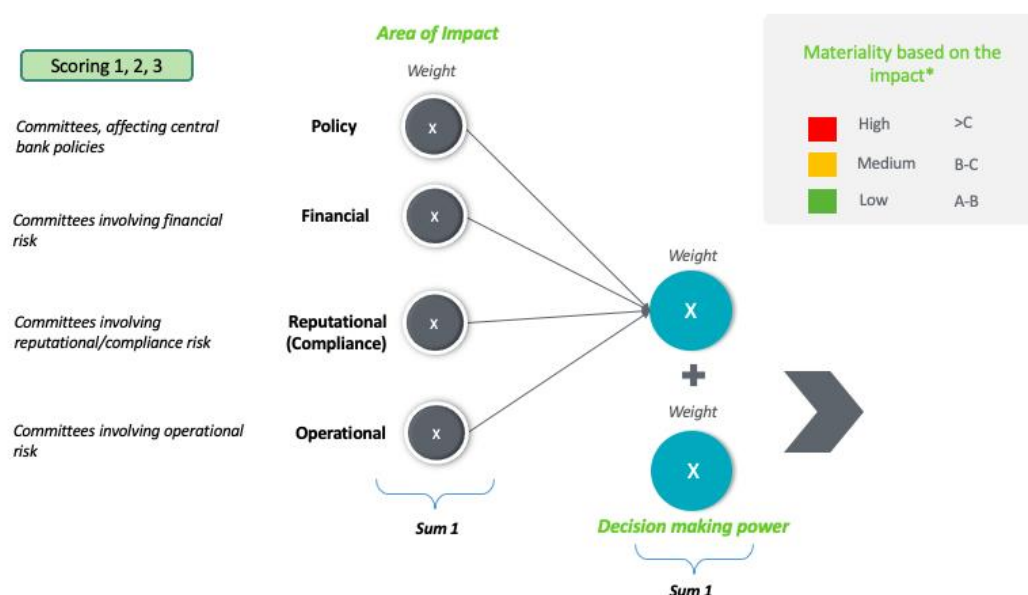
Figure 5. Central Bank Decision-Making Responsibilities



IMF, WP/19/293, The role of Board Oversight in Central bank Governance

56. Furthermore, the audit team from the oversight perspective has examined selected Board meetings. Special focus was on information quality and access, meetings dynamics, protocoling and assignment monitoring (for details see section “Assignments” – page 26). This involved analyzing the agendas and meeting minutes to find out the duration or portion dedicated to discussing and managing issues related to oversight. Another testing tool we used to achieve testing targets was a survey conducted with Board members to assess information quality (for details see section “Management information and decision making” – page 25).
57. To evaluate the **permanent committees’** materiality, the audit team has developed a scope-based assessment method of the impact of committees (see Figure 6)²⁵. To ensure a scope-based assessment, we utilized the committees' mandates as outlined in their charters.

Figure 6. Permanent committees’ materiality evaluation methodology



Under this method, the materiality of the committee was assessed by looking at how much it influences policies and deals with different risks, such as financial, reputational, and operational risks. We measured the overall impact of these areas and adjusted it based on their importance.

Figure 7. Permanent committees’ materiality evaluation

	Active/Inactive	Policy	Financial	Operational	Reputation/ Compliance	Decision making	Materiality based on Impact
X committee	Active	1	3	3	2	3	2,13
Y committee	Inactive	1	2	3	3	1	1,53

²⁵ Scores and weights are flexible and subject to alignment according to the institutions risk appetite and profile.

Also, the authority the committee has in making decisions added to its materiality, contributing to a weighted score that reflects its significance (see the picture). After evaluating the materiality of each committee, a list was created categorizing them as high risk, medium risk, or low risk. By incorporating their active or non-active status, we compiled a comprehensive list of committees.

58. For the **meeting organization and meeting minutes**, review techniques, comparison of sampled meetings minutes and recordings, and a survey were used. These approaches allowed for a thorough examination of the organization's procedural and operational aspects. The agenda review involved scrutinizing the planned items and discussions for clarity and relevance. Additionally, comparing sampled meeting minutes and recordings provided insights into the execution of these meetings. Surveys were also employed to gather feedback and perceptions, contributing to a comprehensive evaluation of the technical aspects of the organization and its operational procedures. To gauge the quality of meeting minutes from the user's viewpoint, a survey was conducted among both executive and non-executive Board members. This survey²⁶, aimed at gathering feedback and perceptions, contributed to a thorough evaluation of the technical aspects of the organization and its operational procedures.
59. To thoroughly test **the delegation of authorities**, the audit utilized a dual method comprising interviews and reviews of reports, with a focus on accountability. Additionally, the audit team examined the delegation frameworks themselves to evaluate their effectiveness and adherence to established governance policies and procedures and CBA Law. This approach allowed for a holistic examination of the delegation process, ensuring that both the execution and the underlying frameworks were scrutinized for alignment with organizational objectives and regulatory requirements. Through interviews with key internal stakeholders (such as the Governor, Board members, and directorate executives), the audit gained qualitative insights into how authorities are delegated and executed within the organization. Simultaneously, reviews of pertinent reports provided a robust understanding of the documented framework and its alignment with actual practices. This approach ensured a comprehensive examination of the delegation process, taking into account both the human perspective through interviews and the procedural perspective through report reviews. Emphasizing accountability is integral, ensuring that the delegation aligns with organizational goals and regulatory requirements while fostering responsibility throughout the hierarchy.

Executive Management Structure and Reporting Lines

Testing Target

60. This aspect assessed the organization's management structures, including the executive leadership team and reporting lines, ensuring that they are well-defined, logical, and conducive to efficient decision-making and communication. Additionally, it examined the effectiveness of reporting lines and the proper delegation of responsibilities, including an evaluation of the 'three lines' model ensuring that the distribution of risk management responsibilities was well-balanced²⁷. This model delineates distinct roles across the organization, emphasizing the importance of front-line business units, independent risk management functions, and internal audit as integral components of an effective risk management framework. By prioritizing well-defined management structures and robust

²⁶ The survey used during this audit is presented in Annex 1.

²⁷ See footnote [20]

reporting lines, the audit sought to enhance the central bank's overall governance effectiveness. Moreover, this emphasis on clarity and effectiveness in organizational structures aimed to fortify risk management practices, ensuring a comprehensive and resilient approach to identifying, managing, and mitigating risks across all levels of the organization. Another target was to identify whether reporting processes ensure proper accountability for delegated areas, reinforcing the importance of clear management structures and robust reporting lines.

Testing Tools

61. In this context, the audit team conducted a comprehensive examination, including a review of the structure, functions, reporting lines, periodic operational, financial, and compliance reports, as well as surveys regarding assignments within the central bank's organizational framework. This multifaceted approach involved a detailed analysis of the organization's internal structure, functions, and how reporting lines were established. Additionally, the audit team scrutinized operational, financial, and compliance reports to ensure that they align with organizational objectives. Simultaneously, surveys were employed to gather insights on assignments, contributing to a holistic evaluation of the organization's management structures. The overarching goal was to assess clarity, alignment, and effectiveness across various aspects, identifying areas for improvement and enhancing governance and risk management practices.

Management Information and Decision-Making

Testing Target

62. The target here was to assure that the management information systems in place consistently deliver high-quality data, characterized by accuracy, relevance, timeliness, and completeness. This involves assessing the processes and controls in the information management framework to guarantee the reliability of the data provided to decision-makers. The audit aimed to ascertain that decision-makers were equipped with information that is not only accurate, but also tailored to meet the specific needs of effective decision-making within the governance structure. In governance, where decisions impact the direction and performance of an organization, having trustworthy information is crucial for making informed and strategic choices.

Testing Tools

63. In this sprint, two distinct testing approaches were employed.
64. Firstly, the audit team conducted a specialized information quality test designed for this particular engagement. To evaluate information quality for decision-making, the audit team conducted research on tools assessing decision-making quality and utilized various sources, adjusting them to meet the specific requirements of the audit. The assessment of decision-making effectiveness for committees within the same sample previously used for the "Meetings organization and meetings minutes" sprint involved four key dimensions. These dimensions included the number of participants engaged in decision-making, the number of alternatives, alignment with business goals/strategy, and internal communication of decisions. The audit team established rating levels for each dimension, as depicted in Figure 8 - The Decision-Making Matrix below. The assessment focused on 10 decision-making committees (5 of which were high risk) to comprehend the decision-making processes and information quality associated with them. For each of the

committees' specific number of meetings minutes and recordings were sampled (random sample) depending on the materiality of the committee. The analysis aimed to identify any deviations from the "optimal levels" highlighted in green within the decision-making matrix. The significance of the number of participants lies in its impact on the effectiveness and efficiency of the decision-making process. It allowed for the consideration of diverse perspectives while avoiding unnecessary "noise." The presentation of alternatives was crucial for evaluating the costs and benefits of each option, aiding in the selection of the most favorable one. Ensuring alignment with business goals was pivotal, shedding light on whether daily or strategic management takes precedence. Additionally, internal communication plays a vital role in keeping the entire organization informed about organizational processes, excluding those with a confidentiality level. The comprehensive analysis of these dimensions provided valuable insights into the decision-making dynamics and information quality within the audited committees.

Figure 8. Decision-Making Matrix

<i>Number of participants involved in decision making process</i>	Number of participants	
	1 to 2	Orange
	3 to 7	Green
	8 to 12	Yellow
	13 or more	Red
<i>Number of alternatives</i>	Number of alternatives	
	1	Red
	2 or 3	Yellow
	4 or more	Green
<i>Alignment with business goals</i>	Number of goals	
	0 to 1	Red
	2 to 4	Yellow
	5 or more	Green
<i>Internal communication of decisions</i>		
	Yes	No

65. Secondly, we utilized a questionnaire to evaluate the quality of management information from the perspective of users. This involved gathering feedback on the usefulness of the information utilized in the decision-making process, with input sought from both executive and non-executive Board members. The questionnaire consisted of two key questions. The first question focused on the timeliness of document provision for decision-making, assessing whether participants received meeting documents, including the agenda, early enough for thorough review and discussion. The second question delved into the accuracy, relevance, and completeness of the documentation and information, gauging whether it was sufficient to facilitate an informed decision-making process or to form an appropriate opinion before the meeting. Respondents were asked to provide their answers on a scale from 1 to 4, where 1 indicated total disagreement and 4 signified full agreement. The intentional design of this scale, with four available answers, aimed to prevent the calculation of an average response, encouraging participants to express a more specific level of agreement or disagreement. This approach allowed for a nuanced understanding of user perceptions regarding the timeliness and quality of the management information provided, offering valuable insights for the audit assessment.
66. The combination of these testing methodologies has strengthened the audit process, ensuring a thorough examination of information quality and user satisfaction in the context of governance.

Assignments

Testing Target

67. The testing target here was to determine whether the assignment process ensures the proper and timely implementation of tasks and assignments, while ensuring the existence of adequate assignment reporting mechanisms that encompass both the frequency of reports and the contextual information they provide.

Testing Tools

68. As the CBA has three sources for assignment generation - from the Governor, from the Board meetings, and from the permanent committees - the audit team included all these sources of assignments into the scope. The initial step involved identifying an inventory of all assignments, a crucial aspect for creating a representative sample that accurately reflects the population. Subsequently, the team proceeded to assess the area of impact caused by overdue assignments, recognizing that in the context of central banks, this impact extends to areas such as regulation, supervision of financial institutions, policy-making, governance, etc. The primary focus was to discern which specific areas were most affected by the delayed completion of assignments. In the third step, the team delved into understanding the allocation of overdue assignments based on their typology, encompassing activities such as contract signing, research or analysis preparation, creation of internal regulations, etc. These testing steps facilitated a nuanced understanding of the main challenges and areas of impact associated with overdue assignments, enabling the audit team to provide recommendations for improvement in the assignment management process.
69. Prior to the main testing, the audit team employed a questionnaire with two distinct parts—one for the Board and the other for C-level managers.
- The Board questionnaire focused on two critical aspects. The first question centered around the effectiveness of controlling the execution of assignments, ensuring proper completion, and the existence of specified procedures for reporting in case of non-completion within the deadline. The second question sought feedback on the reporting regarding both completed and non-completed assignments.
 - For C-level managers, the questionnaire comprised two questions as well. The first one gauged the clarity of assignments after meetings, which is very important for timely completion of the assignment. The second one delved into the effectiveness of controlling the execution of assignments, ensuring their proper completion (the same as for the Board, just to understand the deviation between respondents at different levels).

Respondents were asked to provide their answers on a scale from 1 to 4, where 1 indicated total disagreement and 4 signified full agreement. The intentional design of this scale, with four available answers, aimed to prevent the calculation of an average response, encouraging participants to express a more specific level of agreement or disagreement.

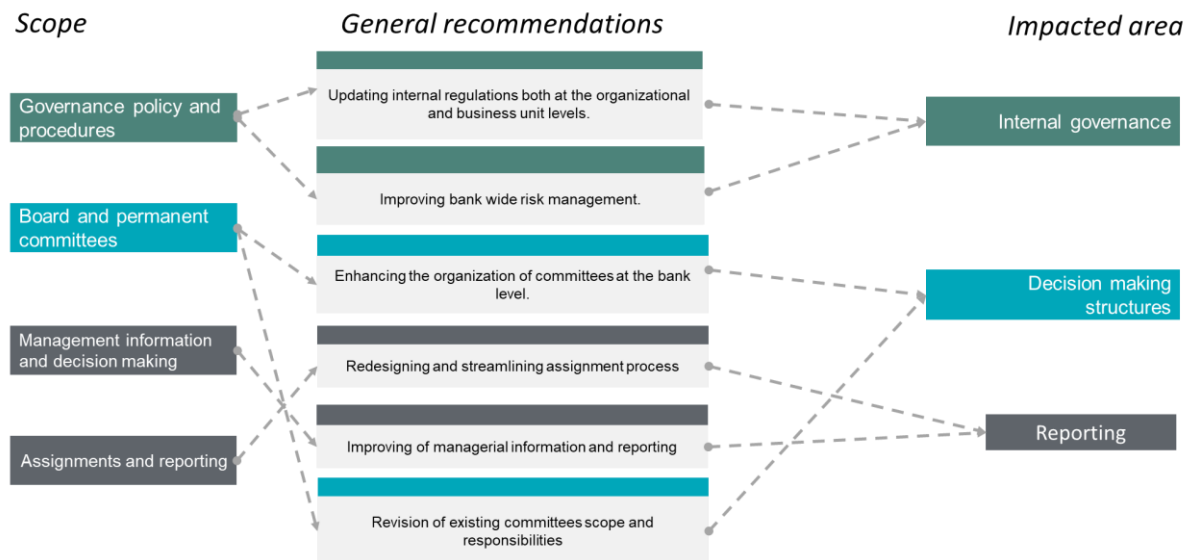
70. This combined approach, incorporating both detailed audit testing steps and internal stakeholder questionnaires has equipped the audit team to offer valuable recommendations for enhancing assignment management processes and effectiveness within the central bank.

IV. OUTCOME OF THE AUDIT

71. Without entering into the confidential details, this governance audit has generated a series of general recommendations designed to address key areas within the central bank. Figure 9 below illustrates the scope of the audit on the left, the impacted areas on the right, and the general recommendations in the center, which serve as the connection between the scope and the impacted areas. This clear connection demonstrates holistic view on how each recommendation is targeted to improve specific aspects of the bank's governance framework. The recommendations include:

- **Updating internal regulations** to strengthen internal governance at both the organizational and business unit levels.
- **Improving bank-wide risk management** to enhance oversight and resilience within the bank's internal governance structure.
- **Enhancing the organization of committees** to optimize decision-making structures and improve the overall efficiency of governance bodies.
- **Redesigning and streamlining assignment processes** to enhance clarity and accountability, impacting decision-making structures.
- **Improving managerial information and reporting**, ensuring timely and accurate data is available to support governance, linked to reporting mechanisms.
- **Revising existing committees' scope and responsibilities** to ensure alignment with the bank's strategic goals, also contributing to better decision-making structures.

Figure 9. Scope of the audit and impacted area



V. LESSONS LEARNED

The following lessons can be drawn from the CBA governance audit:

Governance audits aligned with GIAS.

72. With the experience so far, there is definitely scope for further enhancements to be made in governance audits under the new GIAS through closer linkage with the approach on risk management and making governance assessments consistent with strategic objectives and enterprise risk frameworks. Equally importantly, a focus on the emerging areas of ESG and other relevant risks creates value through better meeting stakeholder expectations and priorities of the organization. The enhanced oversight role of the Audit Committee, as emphasized under the new standards, further ensures that governance audits remain independent, risk-focused, and aligned with the organization's strategic priorities. The adjustments to new standards position internal auditors to deliver governance audits that are forward-thinking and aligned with organizational goals. Accordingly, with the new GIAS, internal auditors can offer deeper insights into the effectiveness of governance processes, increase stakeholder confidence, and support a resilient, transparent governance culture that helps an organization achieve success in the long term.

Support of senior leadership is very important.

73. Governance audits are very important and require support from the senior leadership to run smoothly. The endorsement of the process by senior management and the Board gives it legitimacy, acceptance, and alignment with strategic priorities, while fostering confidence and credibility across the organization. The leadership's cooperation allows for comprehensive data collection, open communication, and a deeper understanding of governance dynamics that promote transparency and accountability.
74. Their involvement further ensures meaningful changes in tune with organizational objectives. Early engagement instills a sense of ownership and develops a sense of urgency, which is instrumental in acting quickly, allocating resources, and resolving issues. The leadership establishes mechanisms for ongoing monitoring and accountability that ensure continuous improvement and adherence to best practices.

It is possible to have “grounded” (data-based) testing of governance controls.

75. At its core, governance audits aim to evaluate how effectively an organization is governed, ensuring that it operates in a manner consistent with its objectives, values, and regulatory requirements. The audit team hence needed to delve into intricate details across different functional areas and levels of the organization to gain a holistic understanding of governance practices. The broad scope of governance audits poses a significant challenge, particularly in light of the perception that governance is non-tangible and difficult to audit. This perception arises from the abstract nature of governance principles and the complex interplay of factors that influence decision-making and behavior.
76. This perception is exacerbated by the lack of clear or specific documentation on governance accessible to the auditing process, which often makes assessment challenging. Governance, often seen as abstract and conceptual, can pose challenges for traditional audit practices that rely heavily on tangible evidence and documentation.

77. However, as complexities within governance structures became more apparent, the audit team realized the need for practical, real-world testing approaches. Therefore, creating "down to earth" and realistic testing methodologies (described in Section III) became essential to conduct this audit. Thus, the audit team could overcome the challenge and dispel the myth that governance is solely abstract or intangible, by developing specialized methodologies tailored to assess real-world scenarios within the CBA.

Mapping findings to management and governance controls.

78. The difference between governance and management lies in their scope and focus: according to ISO 37000 Standard "Governance involves setting, and being accountable for, the organization's fulfilment of its purpose within the parameters set for the organization" and "Management is about fulfilling the associated objectives by making choices within those parameters." Governance controls encompass policies, procedures, and structures designed to guide decision-making and ensure accountability at the highest levels of the organization, whereas management controls involve specific processes and procedures aimed at achieving operational efficiency and effectiveness.
79. The audit team conducted tests and addressed findings separately for both governance and management controls. This signifies that the audit team thoroughly examined and reported on aspects such as high-level policies, decision-making structures, and oversight mechanisms (governance controls), as well as the operational procedures, processes, and systems in place to ensure efficient day-to-day operations (management controls).

It is important for auditors to have a big picture understanding of central banking.

80. The lack of a big-picture understanding can severely impede auditors when tasked with auditing central bank governance. Experienced auditors who have participated in various audits across different sectors of the monetary institution are better equipped to understand the nuances of central bank governance than more narrowly specialized auditors. Through their involvement in audits spanning different areas within the central bank, auditors can develop a broad perspective that enables them to recognize patterns, identify best practices, and anticipate potential challenges within central bank governance. Such auditors can bring valuable insights acquired through exposure to various organizational frameworks and practices to the audit process. Therefore, it is imperative that governance audits of central banks be conducted by experienced auditors who possess a sufficiently broad understanding to navigate the complexities of these institutions effectively.

Additions to the scope of the audit.

81. In addition to reviewing the documents and procedures of the bank, real-life case examples provide a critical source of insight for developing a robust engagement program. These examples provide practical illustrations of how governance failures can arise and the specific control deficiencies that contributed to them. Scenarios like these have to be looked at in order to understand the gaps and vulnerabilities that need to be addressed.
82. Box 1: Selected real-life governance failures underlined, having direct connections with underlying control deficiencies, provide a useful reference to identify patterns of weaknesses, inform the risk assessment, and further refine the design of the engagement program with a view to addressing key governance challenges.

VI. CONCLUSION

83. The authors hope this paper will provide useful insights for internal auditors conducting governance audits for the first time, enabling a comprehensive evaluation and enhancement of governance practices. This paper presented the Central Bank of Armenia's pioneering approach to auditing internal governance, offering a practical, experience-based methodology that internal auditors and senior leaders in central banks can adapt. It demonstrated how agile audit techniques and custom-built assessment tools can be used to evaluate decision-making quality, information flows, and committee structures. The paper also highlighted lessons learned from the CBA's 2023 audit, including the importance of stakeholder engagement, adaptability, and strategic communication. By sharing this case study, the authors aim to contribute to the growing field of governance auditing, offering a concrete starting point for central banks seeking to strengthen institutional trust and accountability through internal audit.

ANNEX 1: SURVEY USED DURING THE AUDIT

The survey consists of 5 separate sections, each of which includes a statement. Individual statements allow to assess the level of satisfaction with the specific sections. Rate your agreement with each statement according to the following scale.

- 1 - Totally disagree
- 2 - Partially disagree
- 3 - Partially agree
- 4 - Fully agree

Timely provision of documents (timeliness)

- ✓ You receive meeting documents (including the agenda) early enough to read and discuss them properly.

Informed decision making

- ✓ The documentation and information provided is sufficient to ensure an informed decision-making process or to form an appropriate opinion prior the meeting.

Management of agendas

- ✓ The agendas of the meetings are well structured (the quantity of questions, duration and complexity are taken into account when preparing the agendas). In case you rated 1 or 2, please indicate what would you change.

Quality of minutes

- ✓ Meeting minutes reflect the content of the discussions, main ideas.
- ✓ Assignment management - Board assessment
- ✓ Controlling the execution of assignments guarantees that assignments are completed properly.
- ✓ I am fully provided with information regarding completed / non completed assignments given by the Board.

Assignment management - Executive managers assessment

- ✓ Assignments after meetings are clear.
- ✓ Controlling the execution of assignments guarantees that assignments are completed properly.

ANNEX 2: GLOSSARY

Agile auditing - an iterative and flexible internal auditing approach inspired by agile principles, emphasizing continuous improvement, stakeholder engagement, and timely insights delivered through adaptive sprints.

Sprint - time period combined with the specific part of the scope, during which audit work is planned, executed, and initially reported.

Testing target - specific goal set by auditors for conducting testing procedures during a certain sprint.

Testing tool - systematic techniques and procedures used to achieve testing targets.

Committee materiality - a scope-based assessment metric used to evaluate the significance of a permanent committee within an organization. It considers the committee's influence on policies, its role in managing financial, reputational, and operational risks, and its decision-making authority.